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MICHIGAN HOUSE OF REPRESENTATIVES

JOHN REILLY

STATE REPRESENTATIVE

COMMITTEES:
FINANCIAL LIABILITY REFORM, VICE CHAIR
JOINT COMMITTEE ON ADMINISTRATIVE RULES, VICE CHAIR
EDUCATION REFORM
ENERGY POLICY
REGULATORY REFORM

February 28, 2018

Dear Chairman Albert and Fellow Members of the Financial Liability Reform Committee,

Thank you for this opportunity to testify in support of my legislation, House Bill 5652, which would amend the Judges Retirement Act to specify that the Department of Technology, Management, and Budget actuary will determine the assumed interest rate for the optional retirement allowance plan offered to judges, rather than hard-coding in statute an 8% assumed interest rate.

HB 5652 would modify Section 604 of the Act, paragraph 8, which begins: "For purposes of determining actuarial equivalent retirement allowances under sections 506(1)(a) and (b) and 602 [the "optional retirement allowance", which may be elected in lieu of the "straight life retirement allowance"], the actuarially assumed interest rate..." It strikes the remainder of the sentence: "shall be 8% with utilization of the 1983 group annuity and mortality table," and replaces that with "determined by the director of the Department and the Retirement Board in consultation with the actuary using the mortality tables adopted by the Department and the Retirement Board." All other amendatory language in the bill is statutory housekeeping and ineffectual.

This is consistent with the changes made in Public Act 92 of 2017, which made the same change to the Michigan Public School Employees Retirement System (MPSERS).

As a general matter, we should avoid hard-coding financial figures in statute, because financial conditions are ever-changing and statutes are designed to resist change. Hard-coding is a software engineering term that describes when a developer, usually in laziness, assigns some control variable to an assumed constant value, rather than a variable the user can modify. The result is that the parameter cannot be modified except by modifying the program, which is typically impossible for a user and often very difficult even for the developer.

By hard-coding "8% with utilization of the 1983 group annuity and mortality table," the Legislature assigned this fixed value in statute, making it very difficult to change. Of course, the financial world is not static and often turbulent. In effect, we are assuring stability for the recipients by transferring the risk to taxpayers.

In MPSERS, faulty assumptions of interest rates led to ten-figure unfunded liabilities. MPSERS is a much larger program, but the error is the same in the Judges Retirement Act: it specifies an interest rate that cannot be changed as the real-world rate changes.

Compensation for state employees can take several forms. Wages and salaries, obviously. Benefits, which are usually in essence restricted proxies for money: You might have health coverage, or else the money to buy it, which is the same, minus the choice.

But there is also a more abstract type of compensation: *the assumption of risk*. When you get down to it, risk is money. Risk and cost are inextricably associated. You can pay to avoid risk, or you can risk more to make more. You can make more money investing in high-yield bonds, if you assume greater risk. Many people take big risks, and some are rewarded. Others lose it all. Institutions tend to avoid risk. They spend a lot of money to minimize risk. They buy insurance. They pay actuaries. They lobby for more stable conditions.

When the State of Michigan promises pensioners a fixed rate of return, it is essentially assuming the risk of investment performance. It is a hidden cost. It is especially dangerous because the policymakers are not the ones assuming the risk. They are not necessarily acting as taxpayers. They tend toward unrealistically optimistic interest assumptions.

This is how our state developed a $29 billion unfunded MPSERS liability. The public assumed the risk, and was liable when investments under-performed.

The bipartisan resolution of MPSERS was the greatest achievement for Michigan's future that we could have enacted. It took us from the road to ruin to the road to redemption.

This legislation does the same for a smaller entity, but it is the same in principle.

We have to be smarter, and design policy resistant to the natural weaknesses of political institutions.

In the bigger picture, we should not offer the taxpayers' risk as a form of compensation to state employees. There is no good reason why one's retirement should not be a completely separate issue from one's compensation.

In the meantime, as a positive step, let's at least modify the code to allow the assumed rate of return to be informed and set according to data, rather than be pegged to a figure that hasn't been updated in at least nine years.

Thank you for your attention in this matter, and I welcome any questions you may have.

Sincerely,

John Reilly

Representative John Reilly